

Personal Trust Reference

Consider the following procedures at each examination. Examiners are encouraged to exclude items deemed unnecessary. This procedural analysis does not represent every possible action to be taken during an examination. The references are not intended to be all-inclusive and additional guidance may exist. Many of these procedures will address more than one of the Standards and Associated Risks. For the examination process to be successful, examiners must maintain open communication with bank management and discuss relevant concerns as they arise.

GENERAL ADMINISTRATIVE

- 1 Determine if management complies with applicable state laws, including:
 - 1 A Prudent Investor Act or Prudent Man Rule.
 - 1 B Principal and Income Act.
- 2 Determine if the tickler systems are adequate Consider the following time sensitive events:
 - 2 A Income remittances to beneficiaries.
 - 2 B Income receipts.
 - 2 C Principal distributions.
 - 2 D Payments for insurance and taxes.
 - 2 E Fee collections.
 - 2 F UCC expirations.
- 3 Determine if significant principal invasions are authorized and prudent.
- 4 Determine if significant discretionary distributions are authorized and prudent.
- 5 Determine if management distributes income in accordance with the terms of the governing instrument.
- 6 Determine if management assesses fees in compliance with the governing instruments or fee schedules.
- 7 Determine if personal trust accounts receive adequate annual administrative and investment reviews.
- 8 Evaluate conflicts of interest that have affected, or could affect, the institution's duty of loyalty. (Note: No breach of the duty of loyalty exists if a transaction is expressly authorized by the governing instrument or is approved by the court.)
- 9 Determine if the receipt of fees from other sources, such as 12b-1 and other mutual fund related fees, is disclosed as required by state law.
- 10 Assess the adequacy of account documentation. Consider the following:
 - 10 A Will, trust agreement, or evidence of appointment.

- 10 B Death certificates.
 - 10 C Birth certificates.
 - 10 D Mortgages and promissory notes.
 - 10 E Property insurance.
 - 10 F Title insurance.
 - 10 G Co-fiduciary approvals.
 - 10 H Appraisals and valuations.
 - 10 I Leases.
 - 10 J Partnership agreements.
 - 10 K Management agreements.
 - 10 L Stock certificates and bonds.
 - 10 M Receipts for expenditures.
 - 10 N Tax returns.
 - 10 O Trade order tickets and confirmations.
- 11 Where the governing instrument creates more than one beneficiary or class of beneficiaries, determine if the institution acts impartially in investing, managing and distributing the trust property.
- 12 Ascertain if account administrators are knowledgeable of the objectives, the administrative requirements, and the circumstances of the beneficiaries of the individual accounts they administer.
- 13 Determine if synoptic records or other electronic account information, adequately summarizes provisions of the governing instruments, including:
- 13 A Names, birth dates, and addresses of beneficiaries.
 - 13 B Names of the grantor's attorney and accountant.
 - 13 C Full description of investment powers, restrictions, limitations or mandatory investments.
 - 13 D Provisions for income distributions.
 - 13 E Provisions for discretionary distributions and principal invasions.
 - 13 F Provisions for termination of the trust and final distribution of assets.
 - 13 G Frequency of customer statements.
 - 13 H Any other matters requiring special attention.

Estates

NOTE: In addition to the general administrative procedures contained above, consider the following procedures for specific account types.

14 Determine that management has the necessary expertise and has a sufficient knowledge of probate laws to administer estates.

15 Assess the administration and settlement of estates. Settling an estate is governed by state probate law, but generally includes the following duties:

15 A Initiating probate proceedings.

15 B Marshalling and inventorying the decedent's assets promptly after acceptance of appointment.

15 C Notifying various parties of the person's death.

15 D Appraising the decedent's assets.

15 E Making claims on behalf of the estate.

15 F Publishing a general notice to all creditors.

15 G Paying claims against the estate.

15 H Locating and notifying beneficiaries and heirs.

15 I Liquidating assets.

15 J Distributing assets in accordance with the will or state intestacy laws.

15 K Filing state and federal estate tax returns.

15 L Obtaining receipts for distributions.

15 M Obtaining court approval for final distribution and settlement of the estate.

16 Determine if management maintains adequate file documentation. Consider the following:

16 A Letters of Administration or Letters Testamentary evidencing court appointment of the institution as administrator or executor, respectively.

16 B Certified copies of the death certificate.

16 C Court orders for discretionary actions not specifically authorized by statute.

16 D Accountings filed with the court.

16 E Receipts for expenses and distributions.

16 F Proof of creditor notifications.

16 G Appraisals and valuations of property.

16 H Tax returns.

17 Determine whether delayed administration of estates has occurred, and if so, did it result from weak administration practices.

Guardianships and Conservatorships

18 Determine if management limits guardianship appointments to those where the institution is appointed as guardian of estates or properties, rather than guardian of individuals.

19 Review account correspondence to determine if management confers with the guardian of the individual to ensure that the institution is aware of any individual needs that may affect administration of the account.

20 Determine if management obtains court orders for discretionary actions not specifically authorized by statute.

21 Determine if accountings have been filed with the court within required timeframes.

Agency Accounts

22 Determine the type and general characteristics of agency accounts that the department administers. (e.g. investment management agencies, investment advisory accounts, custodial accounts, etc.)

23 Determine if agency agreements clearly define the institution's responsibilities.

24 Assess the suitability of investments in agency accounts that grant the department investment discretion, or for which the department provides investment advice.

25 For directed agency accounts, assess management's procedures for obtaining written directives and notifications.

26 Review compliance with the interagency policy statement on the sale of nondeposit investment products, if the trust department engages in activities subject to the policy statement. (Refer to Nondeposit Investment Products ED Module)

Charitable Trusts

27 Determine that charitable trusts are administered in compliance with state law and the Internal Revenue Code (IRC). (Note: Charitable trusts are governed by specific state laws, in addition to state fiduciary laws, and are generally subject to the jurisdiction of the State Attorney General. In addition, because charitable trusts involve specialized tax treatment, numerous sections of the IRC also apply, as outlined in the Internal Revenue Service (IRS) Publication 557.).

28 Determine if internal procedures require legal counsel to review charitable trust documents before acceptance.

29 Determine if management has filed an Application for Recognition of Exemption with the IRS.

30 Where the institution acts as trustee for a private foundation, determine if management has engaged in any acts of self-dealing that may subject the trust to taxes and penalties. [IRC Section 4941 and Treasury Regulation 53.4941(d)]. Self-dealing includes the following transactions:

30 A Sale or exchange, or leasing, of property between a private foundation and a disqualified person.

- 30 B Lending of money or other extension of credit between a private foundation and a disqualified person.
- 30 C Furnishing of goods, services, or facilities between a private foundation and a disqualified person.
- 30 D Payment of compensation (or payment or reimbursement of expenses) by a private foundation to a disqualified person; or transfer to, or use by or for the benefit of, a disqualified person of the income or assets of a private foundation.
- 31 Where the institution acts as trustee for a private foundation, determine if the trust could be subject to excise taxes under the following sections of the IRC:
 - 31 A Failure to distribute income. [IRC 4942]
 - 31 B Excess business holdings. [IRC 4943]
 - 31 C Holding investments that jeopardize the tax-exempt purposes of the foundation. [IRC 4944]
 - 31 D Making taxable expenditures. [IRC 4945]
- 32 Review a sample of income distributions for compliance with the terms of the governing instrument.
- 33 Determine that charitable accounts invested in pooled investment funds comply with Comptroller of the Currency (OCC) Regulation 9.18. Requirements unique to charitable trusts include the following:
 - 33 A Pooled funds must obtain tax-exempt status through IRC Section 584, not Revenue Ruling 81-100.
 - 33 B Participation must be limited to charitable trust accounts that are exempt from income taxes pursuant to IRC Section 501.
 - 33 C Participation must be limited to accounts for which the institution acts as trustee or co-trustee, and not as agent.

Insurance Trusts

- 34 Determine if the institution makes premium payments when due, when it is responsible for making such payments.
- 35 Determine if the institution sends the annual "Crummey Notice", when it is responsible for sending such notices.
- 36 Determine if management periodically assesses the financial condition of insurance companies that underwrite policies held as trust assets.
- 37 Determine if the trust department holds or has held insurance policies issued by companies that have changed their corporate structure from a mutual form of ownership to a stock form of ownership, a process referred to as demutualization. Consider the following:
 - 37 A The trustee voted the demutualization proxy in the best interest of the beneficiaries

37 B The trustee's decision to retain assets received as a result of the demutualization or to sell such assets for cash was appropriate in light of the tax consequences to the beneficiaries and the diversification needs of the trust

Cemetery Trusts

38 Determine if management administers cemetery trusts in compliance with state law. (Note: Cemetery trusts are governed by specific state laws, in addition to state fiduciary laws, and are typically under the jurisdiction of a state agency). State laws may address the following areas:

- 38 A Requirement that perpetual care funds be held in trust.
- 38 B Requirements for expenditures related to perpetual care.
- 38 C Requirement that principal invasions be approved by a representative of the state.
- 38 D Allocation of principal and income.
- 38 E Limitations on investments.

Pre-Need Funeral Contracts

39 Determine if management administers pre-need funeral trusts in compliance with state law. (Note: Pre-need funeral trusts are typically governed by specific state laws, in addition to state fiduciary laws, and under the jurisdiction of a state agency.) State laws may address the following areas:

- 39 A Requirement that funds be held in trust.
- 39 B Limitations on investments.

Land Trusts

- 40 Determine that there is a deed in trust, properly recorded per local law, for properties in the trust.
- 41 Determine that documentation is maintained specifying the persons authorized to provide direction to the trustee.
- 42 Determine that, for all account transactions, written direction is obtained from all persons authorized to direct the trust.
- 43 Determine that all encumbrances on properties held in the trust, such as real estate mortgages or assignments of beneficial interests, are documented and recorded as required by local law.

ACCOUNT ADMINISTRATION REVIEW PROCEDURES FOR SPECIFIC TRUST ASSETS

(Note: The extent of review of the following types of assets should be commensurate with the institution's discretionary responsibilities for the account being reviewed).

Closely Held Business Interests

- 44 Assess the suitability of investments in closely held businesses. Consider the following:

- 44 A Whether the investment was received in kind.
 - 44 B Whether a grantor or other third party directed the investment.
 - 44 C Whether the investment is authorized by the governing instrument.
- 45 Determine if the board considers the following items prior to accepting closely held business interests as trust assets:
- 45 A Financial condition.
 - 45 B Management.
 - 45 C Earnings.
 - 45 D Growth.
 - 45 E Marketability.
 - 45 F Product lines or services.
 - 45 G Competition.
 - 45 H Valuation of the business.
 - 45 I Representation by bank personnel on the board of directors.
 - 45 J Ability to exercise adequate control over the closely held business.
- 46 Evaluate management's plans to retain or dispose of closely held businesses held in accounts.
- 47 If, in its discretion, the department has invested trust assets in a minority interest in a closely held business, evaluate the analysis supporting the prudence of such investments.
- 48 If the institution is responsible for or involved in the day-to-day operations of closely held businesses, determine whether it adequately performs such duties, including attendance at stockholder meetings.
- 49 Evaluate the adequacy of the institution's procedures for selecting and retaining any third-party agents, including relatives of the grantor, for administration of the business.
- 50 Determine whether lending relationships with closely held businesses pose potential conflicts of interest.
- 51 Determine if the institution periodically evaluates the financial condition of closely held businesses.
- 52 Evaluate the adequacy of management's expertise and knowledge of the nature of the product(s) or service(s) that closely held businesses provide.
- 53 Assess the adequacy of valuations of closely held businesses.

Real Estate

54 Evaluate the appropriateness of the institution's decision to invest trust assets in real estate. Consider the following:

- 54 A Whether the investment was received in kind.
- 54 B Whether a grantor or other third party directed the investment.
- 54 C Whether the investment is authorized by the governing instrument.
- 54 D Whether the governing instrument requires retention of the investment.

55 Evaluate management's plans to retain or dispose of real estate held in accounts.

56 Assess the institution's procedures for administering real estate, including:

- 56 A Perfecting title to the property.
- 56 B Performing annual inspections.
- 56 C Evaluating potential environmental liability.
- 56 D Appraising income producing property.
- 56 E Appraising grantor-occupied residences and vacant land periodically.
- 56 F Obtaining adequate insurance that shows the trustee as loss payee.
- 56 G Paying real estate taxes.
- 56 H Maintaining the property.
- 56 I Collecting rental income.

57 Determine if the institution obtains written agreements specifying its responsibilities for holding the grantor's residence, including making payments for taxes, insurance and maintenance.

58 Assess the institution's procedures for selecting and retaining third-party agents.

59 Assess the adequacy of written agreements with third-party agents. Consider the following:

- 59 A Duties and responsibilities of the agent are clearly defined.
- 59 B Commission arrangements are clearly defined.
- 59 C The terms of the agreement are appropriate.

Agricultural Real Estate and Products

(Note: In addition to the examination procedures noted above for all real estate, examiners should consider the following additional examination procedures for agricultural real estate).

60 Assess the adequacy of crop sharing agreements or cash rental agreements for crop land.

61 Evaluate the appropriateness of the amount of farm commodities stored in elevators.

62 Evaluate the institution's procedures for protecting and safekeeping livestock, including inspections.

Mineral Interests

63 Determine whether management has sufficient expertise and knowledge to adequately administer mineral interests.

64 Evaluate the appropriateness of the institution's decision to invest trust assets in mineral interests. Consider the following:

64 A Whether the investment was received in kind.

64 B Whether a grantor or other third party directed the investment.

64 C Whether the investment is authorized by the governing instrument.

64 D Whether the governing instrument requires retention of the investment.

65 Evaluate management's plans to retain or dispose of mineral interests held in accounts.

66 Assess the institution's procedures for administering mineral interests, including:

66 A Obtaining operating agreements.

66 B Obtaining evidence of title.

66 C Reviewing working interests for profitability.

66 D Reviewing working interests for potential environmental liability.

66 E Reviewing expenditures prior to approving payment.

66 F Taking action when payments are not received timely.

66 G Maintaining liability insurance where appropriate.

66 H Establishing ticklers that identify lease expirations or other important information.

Derivatives and other Complex Investments

67 Determine if the governing instrument allows, or does not prohibit, investments in derivatives. (Refer to the FDIC Capital Markets Handbook or the FRB Trading and Capital Markets Activity Manual.)

68 Determine if such investments are allowed, or in any way restricted, under state fiduciary laws.

69 Where governing instruments prohibit the use of derivatives, determine if discretionary accounts invest in mutual funds that hold derivatives as an underlying investment.

70 Determine if the board obtains legal opinions regarding the appropriateness of using derivatives as fiduciary investments.

71 Determine if the board's oversight of all risks associated with derivatives is satisfactory.

72 Determine if the board has adopted formal policies and procedures regarding the use of derivatives and other complex investments. At a minimum, policies and procedures should address the following:

72 A Analyzing the instrument's cash flow under different scenarios, including stress tests, and the resulting effects on price and interest rate risk. Risk analysis of individual instruments should be independent of the investment function.

72 B Establishing timely and accurate risk measurement and monitoring systems.

72 C Reporting policy exceptions.

72 D Establishing price and credit risk approval processes and limits.

72 E Obtaining accurate valuations independent of the broker/dealer.

72 F Reporting risk exposures.

72 G Assessing the liquidity risks against the needs of the account.

72 H Analyzing compliance, reputation, and strategic risks.

72 I Adopting an effective audit program that verifies the integrity of risk measurement and control programs, compliance with internal policies and risk limits, and valuations.

73 Review disclosures given to account holders and presented in common and collective fund agreements.

Mortgages and Notes

74 Assess the suitability of investments in mortgages and notes. Consider the following:

74 A Whether the investment was received in kind.

74 B Whether a grantor or other third party directed the investment.

74 C Whether the investment is authorized by the governing instrument.

74 D Whether the governing instrument requires retention of the investment.

75 Evaluate plans to retain or dispose of mortgages and notes held in accounts.

76 Evaluate procedures for evaluating and monitoring credit risk and determining interest rates.

77 Evaluate practices for maintaining appropriate loan documentation.

78 Evaluate management's practices for enforcing claims. Consider the following:

78 A Monitoring timely payments.

78 B Perfecting collateral.

78 C Sending past due and default notices.

78 D Initiating foreclosure on behalf of the account.

Personal Property

- 79 Determine if management has control over personal property.
- 80 Determine if the governing instrument authorizes or requires retention of personal property.
- 81 Determine if the grantor directs the retention of personal property.
- 82 Determine if management has plans to dispose of personal property.
- 83 Determine if management has obtained adequate valuations where necessary.

Personal Property not in Possession of the Institution

- 84 Determine if the governing document authorizes or directs any trust property to be under the control of anyone other than the trustee.
- 85 Determine if management has obtained a release of liability for such property.
- 86 Determine whether such assets are titled in the name of the institution.
- 87 Evaluate the adequacy of management's procedures to protect and safeguard assets that are not in their possession.

Account Liabilities

- 88 Determine the underlying reasons for account liabilities in discretionary accounts.
- 89 Determine if the governing instrument authorizes the account to incur liabilities.
- 90 Determine if management maintains proper controls and accountings of liabilities.